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FILED
OCT 29 1968
JOHN F. DAVIS, CLERK

IN THE

Supreme Court of the United States

October Term, 1968

No. 450

HAMILTON MEMORIAL GARDENS, INC.,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

REPLY TO MEMORANDUM IN OPPOSITION

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Respondent has submitted a memorandum in opposition to the granting of the writ, in which he raises certain new points.

Respondent's position is that the case only involves a question of timing, *i.e.*, when income is taxable, as opposed to the issue of whether income has been received. This viewpoint demonstrates particularly the necessity for granting the writ of certiorari.

The question here is not a question of timing the petitioner's gross income, *but rather whether petitioner has received any gross income at all.* Petitioner submits that until it is permitted to absorb its capital costs, incurred or estimated, constitutionally it has no gross income which may be taxed.

None of the cases cited by respondent to characterize the issue as one of timing, rather than of substantive gross

income, is pertinent.[1] None involves the determination of gross income; they all deal with expense deductions. None deals with the offset of capital costs against gross receipts. Because the receipts in the tax accounting cases cited by respondent were from services, dues, or interest, there was no question as to the recovery of capital investment. No problem was presented of a tax on gross receipts (the receipts were gross income because no cost of goods sold was involved). The instant constitutional issue was not presented in any of those cases.

This is the first case in which the two principles, tax accounting *vs.* constitutional law, have conflicted. In the past, the Tax Court has held and Commissioner has conceded that the constitutional principle took precedence over accounting rules. *Veenstra & DeHaan Coal Co.* v. *Commissioner,* 11 T.C. 964 (Acquiescence 1949-1 Cumulative Bulletin 4); *Woodlawn Park Cemetery Co.* v. *Commissioner,* 16 T.C. 1067 (Acquiescence 1951-2 Cumulative Bulletin 4).[2] The recent decision of the Tax Court in *Hagen Advertising Displays, Inc.* v. *Commissioner,* 47 T.C. 139, appeal pending (CA.6) contains a full discussion of the issue only in the dissenting opinion. Even now, respondent concedes at page 2 of his Memorandum that there can be no tax on gross receipts.[3]

Respondent argues that the constitutional issue is avoided by allowing an offset for costs in the future. Obviously, this does not meet the established principle that cost must be recovered *first,* and that gross income exists only

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[1] *Schlude* v. *Commissioner,* 372 U.S. 128; *American Automobile Assn.* v. *United States,* 367 U.S. 687; *Commissioner* v. *Hansen,* 360 U.S. 446; *Security Mills Co.* v. *Commissioner,* 321, U.S. 281; *Brown* v. *Helvering,* 291 U.S. 193; *North American Oil* v. *Burnet,* 286 U.S. 417; *Burnet* v. *Sanford & Brooks Co.,* 282 U.S. 359; *Sherwood Memorial Gardens* v. *Commissioner,* 350 F.2d 225.

[2] *Farrara* v. *Commissioner,* 44 T.C. 189, and *Krim-Ko Corp.* v. *Commissioner,* 16 T.C. 31, did not involve the constitutional question because it was not raised by the taxpayers.

[3] See also Income Tax Regulations, §§ 1.61-3(a), 1.61-6(a).

to the extent that proceeds of sale exceed cost. Furthermore, a subsequent cost allowance is not equivalent to a current offset because future gross income might not be adequate to absorb the future expenditure for present costs.[4]

Whether the prepaid receipts for grave spaces and markers were held without restriction is irrelevant. Only that portion of them representing *income* could be taxed.

Respondent erroneously characterizes the expenditures required in the future as "business expenses." They were not expenses; they were capital costs. While estimated business expenses might not be deductible currently under the "annual accounting concept", the same rule is not applicable to the determination of capital costs which must be recovered from gross receipts. This Court has so held in *Burnet* v. *Sanford & Brooks Co.*, 282 U.S. 359, and in *Dobson* v. *Commissioner*, 320 U.S. 489. In the latter case, this Court pointed out that the annual accounting concept cannot be applied in a case involving a recovery of cost, because the constitutional principle overrides tax accounting rules. See also *California and Hawaiian Sugar Refining Corporation, Limited* v. *United States*, 311 F.2d 235 (Ct. Cl.), relying on this Court's holdings.

Respondent states that ". . . there has been consistent and uniform application by the lower courts of the doctrine of taxability of unrestricted prepaid receipts." At the time that respondent's memorandum was submitted, this was a partial truth obtaining only where the case involved service income, or where the constitutional question was not put in issue. However, other cases have recognized the necessity to offset gross receipts by capital costs to obtain gross income.[5] And, there is absolute in-

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[4] It is in the nature of the cemetery business that markers may not be delivered until many years in the future. Because all of the petitioner's income is prepaid, it will have a deduction in some future year which will be wasted, *i.e.*, a net operating loss which cannot be carried back to the years in which receipt occurred.

[5] Petition for Writ, pp. 4, 5.

consistency between the rule permitting real estate developers to subtract estimated development costs in obtaining gross income, and the contrary rule applied to cemeteries.[6]

Reference is made by respondent to legislative history of Section 452 of the Internal Revenue Code of 1954, which dealt with tax accounting for prepaid income. The quotation (Memorandum in Opposition, p. 4) is taken out of context and emphasis is supplied where language was used quite loosely. If the issue were being argued on the merits, the petitioner would show that the reference to payments for "goods" dealt with leases and other cases not involving recovery of costs. It can also be shown that pre-existing law was not as urged by the respondent. At this time, the petitioner need only point out that questions of constitutional law are not normally decided by reference to legislative history. If the tax imposed on petitioner represents an improper tax on gross receipts, no statute or statement of Congressional intent is relevant.

There are two recent developments in the area of tax law involved here. The Seventh Circuit has held as open, reversing the Tax Court, the possibility that prepaid revenues from ticket sales may be deferred.[7] Therefore, the respondent's claim that there is no conflict is not correct, even as to the question of timing. Second, counsel for petitioner has learned that agents of the Internal Revenue Service are proposing deficiencies in a number of cases where retail establishments have received advance payments as "deposits" or have what is known as "lay away" plans. As a result, there are now or shortly will be a substantial number of cases pending for administrative review within the Internal Revenue Service on the precise issue raised in this case. By granting the writ of cer-

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[6] *Ibid.* p. 4.

[7] *Artnell Company* v. *Commissioner*, No. 16586, — F.2d —, (CA 7, September 19, 1968), reversing and remanding 48 T.C. 411.

tiorari and hearing argument, this Court will provide a firm ruling and avoid multiple litigation on a point which is now ripe for hearing.

None of the respondent's arguments opposing the writ of certiorari is valid.

The petition for writ of certiorari should be granted.

Respectfully submitted,

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